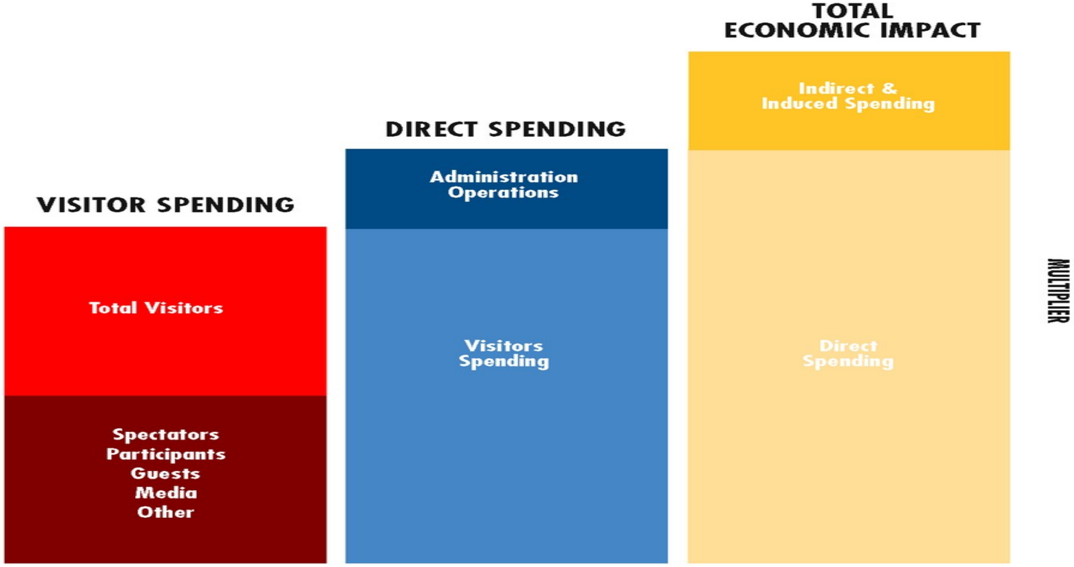
Introduction to Economics of Sport



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What is Sport Economics??

Economics Defined: **"is the process of taking numbers and financial projections from numerous companies or entities to explore future trends" (Fried, Shapiro & DeSchriver, 2008, p. 6).**

Therefore, applied to sport how could we define "Sport Economics"??

Class Activity

Volunteer to give some examples of how “economic forces” impact professional and major amateur sports?

Industrial Organization

Industrial organization is a field of economics that studies the structure of and boundaries between firms and markets and the strategic interactions of firms. The study of industrial organization adds to the perfectly competitive model real-world frictions such as limited information, transaction costs, costs of adjusting prices, government actions, and barriers to entry by new firms into a market that may be associated with imperfect competition.

Public Finance

Public finance is a field of economics concerned with paying for collective or governmental activities, and with the administration and design of those activities. The field is often divided into questions of what the government or collective organizations should do or are doing, and questions of how to pay for those activities. The broader term, public economics, and the narrower term, government finance, are also often used.

The purview of public finance is considered to be threefold: governmental effects on (1) efficient allocation of resources, (2) distribution of income, and (3) macroeconomic stabilization.

Labor

In classical economics and all micro-economics labor is one of three factors of production, the others being land and capital. It is a measure of the work done by human beings. There are macro-economic system theories which have created a concept called human capital (referring to the skills that workers possess, not necessarily their actual work), although there are also counterposing macro-economic system theories that think human capital is a contradiction in terms.

Class Activity

Of the items/economic forces we just listed; how could we divide and/or "place" those among the following 3 areas?

1. Industrial Organization
2. Public Finance
3. Labor

History of the Study of Sport Economics

- Simon Rottenberg: An economist who made his name @ the University of Massachusetts-Amherst is generally considered to be the pioneer of “sport economics”.

Another pioneer in this area of study/research was “Walter Neale”; who wrote a significant paper titled *“The peculiar economics of professional sports”.*

The "Team Sports" industry

The ***team-sport industry*** as an area of inquiry has provided sport-economists the opportunity to ask important and interesting questions:

- ►Is the *objective* of profit maximization described in classical microeconomics textbooks *also* what sport teams/clubs are aiming at?
- ►Or, is a team/club *owner* more interested in winning and what are the implications?

The "Team Sports" industry

- ►*<u>How</u>* has the growing impact of *<u>globalization</u>* and *<u>broadcasting</u>* changed the industry?

- ►Do we need *<u>restrictions</u>* on player mobility to improve *<u>competitive balance</u>*?

The “Team Sports” industry

- How do transfer systems (ie. Free-agency), Revenue sharing arrangements and salary caps affect competitive balance & salary caps, player salaries, ticket prices and owners profits?

Objectives of Club Owners

max π = = max (R-C)

If π indicates "***season*** profits" for a sports franchise; the objective is where "R" is "total season revenue" and "C" is "total season cost" Assuming that the number of players on the team is the only decision variable, the optimal condition for "Profit Maximization" is for the marginal revenue of the players

Objectives of Club Owners

A team maximizes its profits ***if*** the increase in total revenue by hiring one more player is ***equal*** to the increase in the total cost of adding one more player.

As long as the marginal revenue is ***higher*** than the marginal cost; the team/club can increase its profit by hiring more talented players.

Serious “conflicting” objectives

Overall>>> the profit maximization objectives of owners can be characterized as “situationally specific”. The complaints by sports fans that owners such as Jerry Jones of the Dallas Cowboys or Jerry Reinsdorf of the Chicago Bulls and White Sox; who fail to measure up to the “sportsmen” of a bygone era where they *“nurtured the game”* and viewed it more than a “profit center” are creating anecdotal myths or

“Using Sports” to maximize profits elsewhere

Sometimes Team/Club owners might take advantage of the high visibility that professional sports offers in order to ***increase profits*** in another industry.

i.e. The Youmuri Giants-Japan

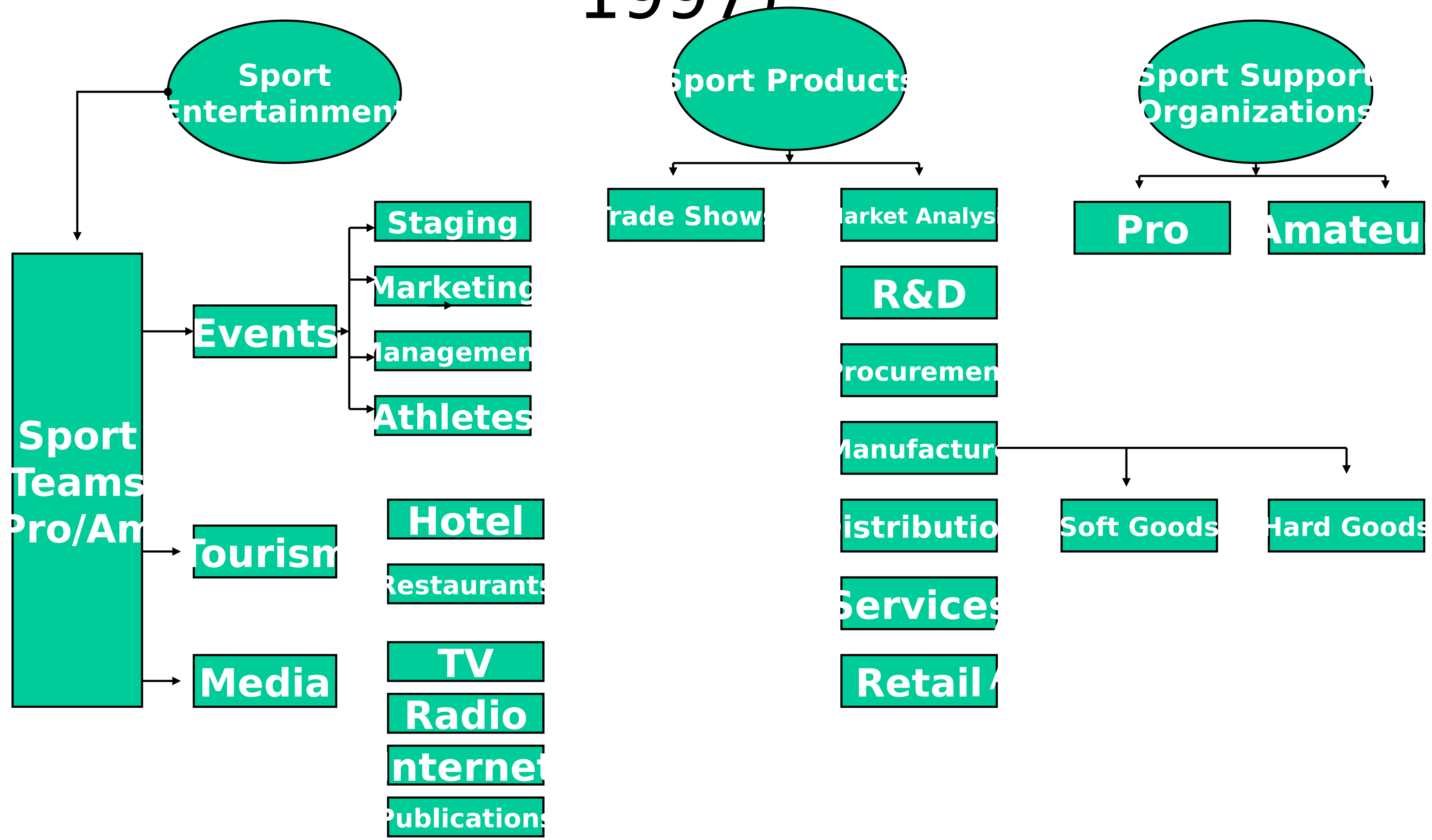
US Example: The creation of the “Anaheim Mighty Ducks” in 1993.

The Sport Industry

Typical sport industry segments include: sport and athletic clubs, intercollegiate athletics, campus recreation, sport marketing,sport communications, sport tourism, semi-professional sports, professional sports, sport event and facility management, and international sport.

In forecasting the sport industry growth for 2015, it is estimated that sport/leisure time activities will account for 50% of the gross national product.

Economic Impact Model (Meek, 1997)



Sport Activity Model (Li, Hofacre, & Mahoney, 2001)

What is the size of the Sport Industry??

It's an elusive & complex measurement!

What is the bottom line regarding the size of the sports industry in the United States?

Humphries of the North American Association of Sport Economists identified three main components of the sports industry: participation in sport, attending sporting events and following sporting events through some form of media.

He estimated that the economic value of these 3 components can be derived by adding up total revenues earned by businesses operating in the sports market (a supply side approach) OR by adding up total expenditures by purchasers in the sports market (a demand side approach).

The “supply side” estimate of the size of the sport industry was considered first. Therefore, ***sales & revenues*** earned by firms participating in the sports market was estimated. Based on collected data on revenues earned by vendors of ***sporting goods*** in 2005 totaled $44.42 billion.

Sporting Goods

What would you guess was the "order" from the largest component to the smallest among sporting goods was?

A. Sporting Equipment
B. Sporting Apparel
C. Footwear

Sporting Goods

C. Footwear ($31.4 Billion), then it was followed by A. Sporting Equipment ($7.5 Billion) and then B. Sporting Apparel ($5.5 Billion).

An “elusive” concept

While this was a bold attempt to define the sport industry in “economic” terms, there are significant limitations and discrepancies that can only be overcome by additional research!

An “elusive” concept

Based on the research done by Humphries; there were no comprehensive estimates of the amount of spending by consumers who follow sports through media such as radio, TV and the Internet. Given the obvious importance of this facet of consumer behavior & the increasing use of the Internet, this gap in the literature clearly needs to be filled!

Economic Impact

Professional Sports: The NFL, the NBA, The NHL and the MLB are all “monopolies”. From a PR standpoint, these leagues contend they are not monopolies, but instead, just “competitors” in a large entertainment industry.

Economic Dynamics

However, the underlying economic dynamics of "team sports leagues" are elusive and different from other industries in one fundamental way. Can you guess what it is?

Economic Dynamics

The teams (companies) that compete against each other on the playing field or court must also **cooperate** with each other to a certain degree as businesses. **Toyota** can produce cars by itself; it does not need Chrysler. The Reds, however, cannot play a game of baseball without another team. **In the team sports industry, it takes *at least two companies* to *produce the desired output.***

Economic Dynamics

The “imbalances” in the market are exacerbated or made more “severe” by the different ownership circumstances on each team!

Market size of the city in which the team exists is another dynamic.

Homework Assignment

Read Chapters 1 & 2 of the textbook